

Auditing Procedures Report

Issued under P.A. 2 of 1968, as amended.

Local Government Type <input checked="" type="checkbox"/> City <input type="checkbox"/> Township <input type="checkbox"/> Village <input type="checkbox"/> Other		Local Government Name CITY OF MUSKEGON HEIGHTS	County MUSKEGON
Audit Date 12/31/05	Opinion Date 6/30/06	Date Accountant Report Submitted to State: 6/30/06	

We have audited the financial statements of this local unit of government and rendered an opinion on financial statements prepared in accordance with the Statements of the Governmental Accounting Standards Board (GASB) and the *Uniform Reporting Format for Financial Statements for Counties and Local Units of Government in Michigan* by the Michigan Department of Treasury.

We affirm that:

1. We have complied with the *Bulletin for the Audits of Local Units of Government in Michigan* as revised.
2. We are certified public accountants registered to practice in Michigan.

We further affirm the following. "Yes" responses have been disclosed in the financial statements, including the notes, or in the report of comments and recommendations

You must check the applicable box for each item below.

- ☐ Yes ☒ No 1. Certain component units/funds/agencies of the local unit are excluded from the financial statements.
- ☒ Yes ☐ No 2. There are accumulated deficits in one or more of this unit's unreserved fund balances/retained earnings (P.A. 275 of 1980).
- ☒ Yes ☐ No 3. There are instances of non-compliance with the Uniform Accounting and Budgeting Act (P.A. 2 of 1968, as amended).
- ☐ Yes ☒ No 4. The local unit has violated the conditions of either an order issued under the Municipal Finance Act or its requirements, or an order issued under the Emergency Municipal Loan Act.
- ☐ Yes ☒ No 5. The local unit holds deposits/investments which do not comply with statutory requirements. (P.A. 20 of 1943, as amended [MCL 129.91], or P.A. 55 of 1982, as amended [MCL 38.1132]).
- ☐ Yes ☒ No 6. The local unit has been delinquent in distributing tax revenues that were collected for another taxing unit.
- ☐ Yes ☒ No 7. The local unit has violated the Constitutional requirement (Article 9, Section 24) to fund current year earned pension benefits (normal costs) in the current year. If the plan is more than 100% funded and the overfunding credits are more than the normal cost requirement, no contributions are due (paid during the year).
- ☐ Yes ☒ No 8. The local unit uses credit cards and has not adopted an applicable policy as required by P.A. 266 of 1995 (MCL 129.241).
- ☐ Yes ☒ No 9. The local unit has not adopted an investment policy as required by P.A. 196 of 1997 (MCL 129.95).

We have enclosed the following:

	Enclosed	To Be Forwarded	Not Required
The letter of comments and recommendations.	✓		
Reports on individual federal financial assistance programs (program audits).			✓
Single Audit Reports (ASLGU).			✓

Certified Public Accountant (Firm Name) Brickley DeLong, PLC			
Street Address 500 Terrace Plaza, P.O. Box 999		City Muskegon	State MI
Accountant Signature <i>Timothy D. Carter, C.P.A. for Brickley DeLong, PLC</i>		ZIP 49443-0999	Date 6/30/06

City of Muskegon Heights
Muskegon County, Michigan

REPORT ON FINANCIAL STATEMENTS
(with required supplementary information)

Year ended December 31, 2005

City of Muskegon Heights
LIST OF ELECTED AND APPOINTED OFFICIALS
December 31, 2005

ELECTED OFFICIALS

Mayor Rillastine Wilkins

Mayor Pro Tem Darrell Paige

City Council..... Keith Guy
Dorothy Scott
Bonnie M. McGlothin
William Watson
Kimberley Sims

APPOINTED OFFICIALS

City Manager Melvin C. Burns, II

City Clerk Kordilia Buckner

Finance Director..... Lori Doody

City Assessor/Treasurer/Income Tax
Administrator Robert Jackson

City of Muskegon Heights

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As management of the City of Muskegon Heights, we present to the readers of the City's financial statements this overview and analysis of the financial activities of the City of Muskegon Heights for the fiscal year ended December 31, 2005. We encourage you to consider the information presented in these financial statements along with the additional information that has been furnished in this letter.

FINANCIAL HIGHLIGHTS

- The City of Muskegon Heights Water Supply Fund issued \$6,850,000 in refunding bonds that resulted in an economic gain of approximately \$464,000.
- The City spent approximately \$360,000 in repaving Fifth Street which was partially funded with a State of Michigan grant and a special assessment.
- The City's Major Street Fund is on track with its deficit elimination plan. The Fund deficit decreased from \$150,402, in 2004 to \$74,264, in 2005.
- The City's Cemetery Fund was also on target with its deficit reduction plan and reduced its fund deficit to \$5,008.

OVERVIEW OF THE FINANCIAL STATEMENTS

The discussion and analysis is intended to serve as an introduction to the City's basic financial statements. The City's basic financial statements are comprised of three components: 1) government-wide financial statements, 2) fund financial statements and 3) notes to the financial statements. This report also contains other supplementary information in addition to the basic financial statements themselves.

Government-wide Financial Statements

The government-wide financial statements are designed to provide the reader with a broad overview of the City's finances. These statements are similar to those of a private sector business.

The Statement of Net Assets presents information on all of the City's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the City is improving or deteriorating.

The Statement of Activities presents information showing how the City's net assets changed during the fiscal year. All changes in net assets are reported when the event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in the future fiscal periods.

Both of the government-wide financial statements mentioned above distinguish functions of the City that are principally supported by taxes and intergovernmental revenues (governmental activities) from other functions that are designed to recover all or a significant part of their costs through user fees and charges for services (business-type activities). The governmental activities of the City of Muskegon Heights include general government, public safety, public works, community and economic development, and cultural and recreational activities. The business-type activities of the City include water distribution, water filtration and sewer services.

The government-wide financial statements include not only the City of Muskegon Heights (the primary government) but also the legally separate Muskegon Heights Downtown Development Authority. The board of this organization is appointed by the City and given the interrelation, there is some potential liability for the City due to the City's pledge of its full faith and credit for debt obligations. The financial information of this component unit is reported in a separate column from the financial information of the primary government itself.

Fund Financial Statements. A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The City of Muskegon Heights, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of the City can be divided into three categories-governmental funds, proprietary funds and fiduciary funds.

Governmental Funds. Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on current sources and uses of spendable resources, as well as on balances of spendable resources available at the end of the fiscal year. This information may be useful in evaluating a governmental entity's short-term financing requirements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's short-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between the two.

The City of Muskegon Heights maintains more than a dozen individual governmental funds. Information is presented separately in the governmental fund balance sheet and in the governmental fund statement of revenues, expenditures and changes in fund balances for the General Fund, which is considered a major fund. Data from the other funds are combined into a single, aggregated presentation. Individual fund data for each of these non-major governmental funds is provided in the form of combining statements elsewhere in this report.

Proprietary Funds. The City of Muskegon Heights has one type of proprietary fund. Enterprise funds are used to report the same functions presented as business-type activities in the government-wide financial statements. The City uses enterprise funds to account for its water distribution, water filtration and sewer services.

Enterprise funds provide the same type of information as the government-wide financial statements, only in more detail. The enterprise funds financial statements provided separate information for Water, Water Supply and Sewer funds, all of which are major funds.

Fiduciary Funds. Fiduciary Funds are used to account for resources held for the benefit of parties outside the City. Fiduciary funds are not reflected on the government-wide financial statements because the resources from those funds are not available to support the City's programs. The accounting method used for fiduciary funds is much like that used for the proprietary funds.

Notes to the Financial Statements. The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The reader is encouraged to include the reading of this section in any attempt to analyze and understand these statements.

Other Information. In addition to the basic financial statements and accompanying notes, this report also presents certain required supplementary information concerning the City's budgetary information as it relates to the actual expenditures for the General Fund.

Government-wide Financial Analysis

The first table presented below is a summary of the government-wide statement of net assets for the City of Muskegon Heights. As stated earlier, the net assets may be used as an indicator of a government's financial health. As of December 31, 2005, the City's net assets from governmental activities totaled \$8,354,405 (46%) and \$10,034,984 (54%) from business-type activities, creating a total government-wide net assets total of \$18,389,389. The City's total net assets decreased 7% from 2004 to 2005. The overall net assets decrease was primarily due to the depreciation of the City's infrastructure.

The changes in current assets and other assets and current liabilities were due to the timing of payment of the liabilities. Capital assets decreased due to depreciation of capital assets which was partially offset by capital asset addition during the year. Noncurrent liabilities decreased due to normal scheduled repayment of debt.

In examining the composition of these net assets, the reader should note that governmental activities net assets are invested in capital assets (i.e., streets, buildings, land, vehicles, equipment, etc.). These assets are used to provide services to the City's residents, and they are not available to pay salaries, operational expenses or fund capital projects. The unrestricted net assets for governmental-type activities' depicted a deficit of \$1,476,213 at December 31, 2004. For the year ended December 31, 2005, that amount improved by \$336,558 to a deficit of \$1,139,655.

Business-type activities continue to have positive net assets, which are primarily comprised of invested in capital assets, net of related debt and net assets restricted for debt service. The total for unrestricted net assets for business-type activities at December 31, 2005 was \$1,707,050. This represents 17% of business-type activities total net assets. This represents a decrease in unrestricted net assets of \$535,061 due to operating losses and purchases of capital assets with current assets. The Sewer Fund's unrestricted net assets decreased approximately 12% in 2005 to \$1,263,272. This decrease was primarily due to the repayment of debt and a current year operating loss. The Water Fund, which had an unrestricted deficit of \$219,686 at the close of 2004, decreased its unrestricted deficit in 2005 to \$43,090. This improvement was due to a transfer from the Water Supply Fund of \$179,576. The Water Supply Fund unrestricted net assets decreased by \$822,494 to \$486,868. This decrease was due to an loss before transfers of \$743,918 during the year and a transfer of \$179,576 to the Water Fund.

Net Assets

	Governmental Activities		Business-type Activities		Total	
	2005	2004	2005	2004	2005	2004
Current assets and						
other assets	\$ 2,908,446	\$ 2,479,076	\$ 6,560,478	\$ 3,105,847	\$ 9,468,924	\$ 5,584,923
Capital assets	9,856,921	10,555,234	21,886,373	26,528,954	31,743,294	37,084,188
Total assets	12,765,367	13,034,310	28,446,851	29,634,801	41,212,218	42,669,111
Current liabilities	2,057,617	1,615,205	1,450,415	1,283,736	3,508,032	2,898,941
Noncurrent liabilities	2,353,345	2,513,266	16,961,452	17,394,501	19,314,797	19,907,767
Total liabilities	4,410,962	4,128,471	18,411,867	18,678,237	22,822,829	22,806,708
Net assets						
Invested in capital assets,						
net of related debt	8,762,653	9,669,899	5,843,582	6,575,641	14,606,235	15,672,559
Restricted	731,407	712,153	2,484,352	2,138,812	3,215,759	2,562,099
Unrestricted	(1,139,655)	(1,476,213)	1,707,050	2,242,111	567,395	1,627,745
Total net assets	\$ 8,354,405	\$ 8,905,839	\$ 10,034,984	\$ 10,956,564	\$ 18,389,389	\$ 19,862,403

Governmental Activities. Governmental activities net assets decreased by \$430,840 or 5% during the 2005 fiscal year. This decrease is primarily the result of depreciation of the City's infrastructure exceeding current year infrastructure additions. With all of the City's governmental operations combined, the net result was that its operating revenues were exceeded by its operating expenditures, producing the resulting decrease in net assets. The following table depicts this occurrence which will be discussed in more detail later in this analysis.

In comparing last years financial statements, operating grants and capital grants decreased due to a drop in Community Development Block Grant revenues and a decrease in Home Land Security grants. Property taxes increased due to an increase in property tax mills and a normal increase in taxable value. Grants and contributions not restricted decreased due to a drop in State of Michigan revenue sharing. Miscellaneous revenues increased due to two refunds for health insurance and workers compensation insurance. In comparing last year expenses, community and economic development decreased due to a decrease in CDBG grant expenditures and 2004 had a grant for housing that did not continue in 2005. Interest expense on long-term debt increased due to a full year of interest on the budget stabilization bonds issued in 2004.

Business-type Activities. Total net asset for business-type activities decreased from \$10,956,564 in 2004 to \$10,034,984 in 2005. This is a decrease of approximately 8%. The decrease is primarily due to operating losses incurred during the year. Charges for services increased due to an increase in usage and an increase in rates charged. Investment earnings increased due to better investment rates. Sewer expenses increased due to additional costs incurred due to an agreement to reduce the rates paid by one large industrial customer in the county. This decrease in rates was transferred and born by the remaining users of the County wastewater system. Water distribution costs increased due to a large water main repair during the year. Water Supply Fund expenses increased due to filling various positions that had been vacant in the prior year. Overall, this resulted in an decrease in business-type net assets of \$921,580 for the year.

Change in Net Assets

	Governmental Activities		Business-type Activities		Total	
	2005	2004	2005	2004	2005	2004
Revenues:						
Program revenues						
Charges for services	\$ 831,714	\$ 862,695	\$ 4,598,909	\$ 4,285,584	\$ 5,430,623	\$ 5,148,279
Operating grants	1,407,144	1,880,592	-	-	1,407,144	1,880,592
Capital grants and contributions	375,087	462,938	-	-	375,087	462,938
General revenues						
Property taxes	2,139,942	1,961,330	-	-	2,139,942	1,961,330
Income taxes	1,016,829	1,020,227	-	-	1,016,829	1,020,227
Franchise fees	80,347	91,874	-	-	80,347	91,874
Grants and contributions not restricted	1,836,180	1,926,545	-	-	1,836,180	1,926,545
Unrestricted investment earnings	28,354	39,005	173,453	100,550	201,807	139,555
Miscellaneous	335,297	137,505	-	-	335,297	137,505
Gain on sale of assets	15,858	(21,423)	-	-	15,858	(21,423)
Total revenues	8,066,752	8,361,288	4,772,362	4,386,134	12,839,114	12,747,422
Expenses:						
General government	2,019,164	2,174,833	-	-	2,019,164	2,174,833
Public safety	3,348,447	3,376,259	-	-	3,348,447	3,376,259
Public works	2,339,557	2,266,537	-	-	2,339,557	2,266,537
Community and economic development	369,123	744,461	-	-	369,123	744,461
Culture and recreation	350,395	314,126	-	-	350,395	314,126
Interest on long term debt	103,447	59,984	-	-	103,447	59,984
Sewer	-	-	942,016	792,153	942,016	792,153
Water distribution	-	-	1,443,764	1,225,426	1,443,764	1,225,426
Water supply	-	-	3,275,621	2,796,131	3,275,621	2,796,131
Total expenses	8,530,133	8,936,200	5,661,401	4,813,710	14,191,534	13,749,910
Increase in net assets before transfers	(463,381)	(574,912)	(889,039)	(427,576)	(1,352,420)	(1,002,488)
Transfers	32,541	24,268	(32,541)	(24,268)	-	-
Change in net assets	(430,840)	(550,644)	(921,580)	(451,844)	(1,352,420)	(1,002,488)
Net assets - Beginning, restated	8,785,245	9,456,483	10,956,564	11,408,408	19,741,809	20,864,891
Net assets - Ending	\$ 8,354,405	\$ 8,905,839	\$ 10,034,984	\$ 10,956,564	\$ 18,389,389	\$ 19,862,403

Financial analysis of the Government's Funds

As stated earlier in this discussion and analysis, the City of Muskegon Heights uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

Governmental funds. The focus of the City of Muskegon Heights governmental funds is to provide information on near-term inflows, outflows and balances in spendable resources. Such information is useful in assessing the City's financing requirements. In particular, unreserved fund balances or the lack thereof, may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

At the end of the 2005, the City of Muskegon Heights governmental funds reported a combined unreserved fund balance of \$64,334. It is necessary to further distinguish between the unreserved and reserved fund balance. The unreserved balance represents what is available for spending at the City's discretion. The remainder of the fund balance is reserved to indicate that it is not available for new spending because it has already been committed to 1) liquidate contracts and purchase orders (\$225,466), 2) pay debt service and capital purchase (\$30,493), and 3) reserves for cemetery perpetual care (\$511,378). When the fund balance has been adjusted to account for these reserves, the result is a total fund balance of \$831,671, which consists of a fund balance of \$129,573 in the General Fund and a fund balance of \$702,098 in other governmental funds.

The General Fund is the chief operating fund of the City of Muskegon Heights. At the end of the 2005, the unreserved General Fund deficit was \$95,893 and the total General Fund fund balance was \$129,573. As mentioned earlier, property taxes increased due to an increase in property tax mills and an increase in taxable value and an increase in collections on delinquent personal property taxes. Federal revenues decrease due to a drop in Homeland Security grants during the year. Fines and forfeitures increased due to a release of confiscated monies. Other revenues increased due to two insurance refunds received during the year. Proceeds from long-term debt were higher in the prior year due to the 1.5 million in budget stabilization bonds issued in 2004. Capital outlay decreased due to fewer purchases. Transfers out increased due to transferring a full years worth of debt service monies related to the 1.5 million in bonds issued in 2004.

The other governmental funds column consists of various funds. The Major Street Fund is the largest fund in that schedule. The Major Street Fund improved its fund equity by \$76,138, which reduced the end of year fund deficit to \$74,264.

Proprietary funds. The City of Muskegon Heights proprietary funds provide the same type of information found in the governmental financial statements, but in more detail. Net assets of the Sewer Fund decreased by \$98,415 due to the increased costs noted earlier. The net assets of the Water Fund increased by \$132,870 due to a transfer from the Water Supply Fund. The Water Supply Fund's net assets decreased by \$956,035. This decrease was due to an increase in operating expenses due to filling employee positions vacant in the preceding year and a transfer of \$179,576 to the Water Fund. As stated above, the net assets of the three proprietary funds combined, decreased 8%, from \$10,956,564 in 2004 to \$10,034,984 in 2005.

General Fund Budget

During 2005 fiscal year, the former City Manager recommended several budget amendments to the City's General Fund. The most significant amendments occurred in the following:

- Amended General Fund revenues to \$6.25 million dollars due to higher than anticipated taxes and insurance refunds. However, the budget did not provide for any break down of the amended revenues.
- The City attorney budget was increased by \$30,000 largely due to ongoing arbitration with patrol officers bargaining unit and increased activity relative to income tax and person property collections.
- The City clerk budget was increased due to payment of accrued sick and vacation related to a retiring employee.
- Other general government budget was increased due to an increase in retiree health care benefits and an increase in general insurance costs.
- The police budget was increased to account for unexpected overtime costs.
- The auto theft grant was not anticipated at the time of the original budget, but was included in the amended budget.
- The fire department budget was increased due to unanticipated overtime costs.
- The street lighting budget was originally budgeted too high and was reduced to reflect actual costs.
- The refuse collection budget was increased by \$90,000 to cover higher than expected cost.
- The original debt service expenditures were inaccurate and reduced to closer reflect actual expenses.

Variances in budget to actual revenues and expenditures for the 2005 fiscal year are summarized as follows:

Revenues - Since no detailed amended budget was provided, we are comparing the actual revenue amounts against the original revenue budget.

- Tax revenue was up by \$200,000 largely due an additional millage levied for debt service.
- Intergovernmental revenue was down by approximately \$28,000 due to the impact of economic conditions on state revenue sharing.
- Charges for services and fines and forfeitures combined revenues were over budget by \$64,000 due to higher fees, release of confiscated funds and a concerted effort to ensure that all allowed fees were charged and collected.
- Miscellaneous revenue was over budget by \$93,000 primarily due to unexpected insurance refunds received.

Expenditures

- Other general government expenditures were over budget due to unexpected health insurance, general insurance and workers compensation insurance expenditures.
- The police and fire expenditures were under budget due the final amended budget including approximately \$150,000 in prior year payroll taxes that are shown as a prior period adjustment.
- The parks department was over budget due to reallocation of an employee to the parks department including the associated costs.
- Principal was over budget due reclassification of capital lease payment from various other departments.
- Capital outlay and proceeds from long-term debt were primarily over budget due to the final amended budget not accounting for equipment purchased with capital leases.
- The amended budget for transfers fails to include the normal transfer from capital projects fund.
- Transfers out were over budget since the amended budget did not include all required debt service payments.

Capital Assets. The City of Muskegon Heights investment in capital assets for its governmental and business-type activities was \$32,822,580 (net of accumulated depreciation) at the close of 2004. In 2005, this total decreased approximately 3% to \$31,743,294. The investment in capital assets includes land, buildings, infrastructure, improvements, machinery, equipment, plants and vehicles.

Major capital asset events during the current fiscal year included the following:

- Fifth Street was repaved for approximately \$360,000.
- Four vehicles were added during the year for \$67,570.
- Building improvements to the water treatment plant for \$112,600.
- Equipment additions at the water treatment plant for approximately \$223,000.

CAPITAL ASSETS
(Net of Accumulated Depreciation)

	Governmental Activities		Business-type Activities		Total	
	2005	2004	2005	2004	2005	2004
Land	\$ 254,408	\$ 254,408	\$ 40,012	\$ 40,012	\$ 294,420	\$ 294,420
Buildings and improvements	666,960	692,665	108,377	-	775,337	692,665
Infrastructure	7,104,450	7,652,085	-	-	7,104,450	7,652,085
Plants and infrastructure	-	-	21,666,287	22,255,170	21,666,287	22,255,170
Furniture and equipment	842,769	881,700	-	-	842,769	881,700
Machinery and equipment	-	-	71,697	28,747	71,697	28,747
Vehicles	988,334	1,017,793	-	-	988,334	1,017,793
Total	<u>\$ 9,856,921</u>	<u>\$ 10,498,651</u>	<u>\$ 21,886,373</u>	<u>\$ 22,323,929</u>	<u>\$ 31,743,294</u>	<u>\$ 32,822,580</u>

Additional information on the City's capital assets can be found in Note D of the financial statements.

Long-term debt. At the end of the 2005 fiscal year, the City of Muskegon Heights had total outstanding debt of \$20,253,557 consisting of general obligations bonds, revenue bonds, capital leases, installment purchase agreements and compensated absences. Total outstanding debt decreased slightly due to normal scheduled debt retirements exceeding current year additions. During the year, the City entered into several small installment purchase and capital lease agreement. Total additions for the year were \$78,016. In addition, the City's Water Supply Fund refunded \$6,255,000 of the 2000 Water Supply System Revenue Bonds. This resulted in an economic gain of approximately \$464,000.

OUTSTANDING DEBT

	Governmental Activities		Business-type Activities		Total	
	2005	2004	2005	2004	2005	2004
General obligation bonds	\$ 2,145,000	\$ 2,165,000	\$ -	\$ -	\$ 2,145,000	\$ 2,165,000
Capital leases	78,458	68,277	-	-	78,458	68,277
Installment purchase agreements	59,888	95,475	-	-	59,888	95,475
Compensated absences	410,922	397,514	-	-	410,922	397,514
Revenue bonds	-	-	17,559,289	17,548,064	17,559,289	17,548,064
Total	<u>\$ 2,694,268</u>	<u>\$ 2,726,266</u>	<u>\$ 17,559,289</u>	<u>\$ 17,548,064</u>	<u>\$ 20,253,557</u>	<u>\$ 20,274,330</u>

Additional information on the City of Muskegon Heights' long-term debt can be found in Note I of the financial statements.

General Economic Overview

In March 2006, the City's leadership changed. The transition to new leadership will have an impact on overall management of the City. As part of this change in leadership, the City's General Fund may incur a liability to the former City manager for sick and vacation pay and possibly other wages as part this transition.

The City of Muskegon Heights will continue to face economic challenges due to socioeconomic conditions and the overall economic health of the State of Michigan. Property tax revenue, City income tax revenue, state revenue sharing and water and sewer charges for services are the major sources of revenue for the City. The reduction in staff and equipment at Dana will have an impact on personal property taxes, City income taxes and water and sewer revenues. Some of these items were affected in 2005 during the last three months of the year, but fiscal year 2006 will see the full impact of this plant closing.

The City of Muskegon Heights like many other governmental entities will be looking more closely at the services it provides and the necessity and costs of providing those services. The City expects to be more involved in providing services jointly with other municipalities, cooperative purchasing and eliminating services duplicated by other organizations.

In addition to looking at ways to reduce expenditures, future planning should include the benefits of having designations such as Enterprise Zones, Brownfield, Renaissance Zone and the recently announced Cities of Promise community as potential new revenue sources. We must also pursue new grants and consider other options (i.e. special assessments, special assessment bond) to address our City's street and infrastructure needs.

Redevelopment of City owned property, the former sewage treatment plant, the 12 acres along Seaway Drive, the former Lab Furniture site at Sixth and Broadway and the former Bennett Pump site are resources whose development must be conducive to meeting the needs of an urban community and assure residents and taxpayers of sound fiscal management.

The business-type funds had a number of significant developments. In January 2006, the City issued refunding bonds that will generate an economic gain of approximately \$682 thousand dollars over the life of the bonds. This savings will result in lower costs at the Water Supply Fund. Due to the loss of the Dana factory, water and sewer rates were increased part way through the fiscal year 2005. Therefore fiscal year 2006 will be the first full year with the rate increases in place. This rate increase is needed for operations and system improvements. The above items should all have a positive affect on overall result of the business-type activities.

Requests for Information

This financial report is designed to provide a general overview of the City of Muskegon Heights' finances for all those with an interest. Questions concerning any of the information provided in this report or requests for additional information should be addressed to the City of Muskegon Heights, Finance Department, 2724 Peck Street, Muskegon Heights, Michigan 49444, (231) 733-8870.

BRICKLEY DeLONG

CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITORS' REPORT

June 30, 2006

City Council
City of Muskegon Heights
Muskegon Heights, Michigan

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information of the City of Muskegon Heights as of and for the year ended December 31, 2005, which collectively comprise the City's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the City of Muskegon Heights' management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information of the City of Muskegon Heights, as of December 31, 2005, and the respective changes in financial position and, where applicable, cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The managements' discussion and analysis and budgetary comparison information on pages i - x and 36 - 37 are not a required part of the basic financial statement but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

BRICKLEY DELONG

City Council
June 30, 2006
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Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City of Muskegon Heights' basic financial statements. The combining nonmajor fund financial statements are presented for purposes of additional analysis and are not a required part of the basic financial statements. The combining nonmajor fund financial statements have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Brickley DeLong, PLC

City of Muskegon Heights
STATEMENT OF NET ASSETS (DEFICITS)
December 31, 2005

	ASSETS			Component unit
	Governmental activities	Business-type activities	Total	Downtown Development Authority
CURRENT ASSETS				
Cash and investments	\$ 766,193	\$ 2,149,552	\$ 2,915,745	\$ 240,422
Receivables	866,434	551,734	1,418,168	166,745
Due from component unit	30,734	-	30,734	-
Internal balances	167,098	(167,098)	-	-
Due from other governmental units	606,529	-	606,529	-
Inventories	89,927	25,439	115,366	-
Prepaid items	200,539	-	200,539	-
Total current assets	2,727,454	2,559,627	5,287,081	407,167
NONCURRENT ASSETS				
Restricted assets	-	3,385,109	3,385,109	-
Capital assets, net				
Nondepreciable	254,408	40,012	294,420	294,635
Depreciable	9,602,513	21,846,361	31,448,874	599,472
Access rights, net	-	208,952	208,952	-
Bond issue costs, net	45,696	406,790	452,486	-
Special assessments receivable	135,296	-	135,296	-
Notes receivable	-	-	-	26,000
Total noncurrent assets	10,037,913	25,887,224	35,925,137	920,107
Total assets	12,765,367	28,446,851	41,212,218	1,327,274
LIABILITIES AND NET ASSETS (DEFICIT)				
CURRENT LIABILITIES				
Accounts payable and accrued liabilities	511,371	835,569	1,346,940	27,403
Due to primary government	-	-	-	30,734
Due to other governmental units	3,124	-	3,124	-
Deferred revenue	1,202,199	17,009	1,219,208	166,224
Bonds and other obligations, due with one year	340,923	597,837	938,760	70,446
Total current liabilities	2,057,617	1,450,415	3,508,032	294,807
NONCURRENT LIABILITIES				
Bonds and other obligations, less amounts due within one year	2,353,345	16,961,452	19,314,797	727,723
Total liabilities	4,410,962	18,411,867	22,822,829	1,022,530
NET ASSETS (DEFICIT)				
Invested in capital assets, net of related debt	8,762,653	5,843,582	14,606,235	95,938
Restricted for:				
Capital projects	26,161	417,118	443,279	-
Highways and streets	189,536	-	189,536	-
Debt service	4,332	2,067,234	2,071,566	-
Nonexpendable perpetual care	511,378	-	511,378	-
Unrestricted	(1,139,655)	1,707,050	567,395	208,806
Total net assets	\$ 8,354,405	\$ 10,034,984	\$ 18,389,389	\$ 304,744

The accompanying notes are an integral part of this statement.

City of Muskegon Heights
STATEMENT OF ACTIVITIES
For the year ended December 31, 2005

Functions/Programs	Net (Expense) Revenue and Changes in Net Assets							
	Expenses	Program Revenue			Primary Government			Component Unit
		Charges for services	Operating grants and contributions	Capital grants and contributions	Governmental activities	Business-type activities	Total	Downtown Development Authority
Primary government								
Governmental activities								
General government	\$ 2,019,164	\$ 271,637	\$ 67,018	\$ -	\$ (1,680,509)	\$ -	\$ (1,680,509)	\$ -
Public safety	3,348,447	203,772	30,509	10,053	(3,104,113)	-	(3,104,113)	-
Public works	2,339,557	297,160	849,764	365,034	(827,599)	-	(827,599)	-
Community and economic development	369,123	10,261	384,908	-	26,046	-	26,046	-
Culture and recreation	350,395	48,884	15,000	-	(286,511)	-	(286,511)	-
Interest on long-term debt	103,447	-	59,945	-	(43,502)	-	(43,502)	-
Total governmental activities	8,530,133	831,714	1,407,144	375,087	(5,916,188)	-	(5,916,188)	-
Business-type activities								
Sewer	942,016	817,386	-	-	-	(124,630)	(124,630)	-
Water	1,443,764	1,395,381	-	-	-	(48,383)	(48,383)	-
Water Supply	3,275,621	2,386,142	-	-	-	(889,479)	(889,479)	-
Total business-type activities	5,661,401	4,598,909	-	-	-	(1,062,492)	(1,062,492)	-
Total primary government	\$ 14,191,534	\$ 5,430,623	\$ 1,407,144	\$ 375,087	(5,916,188)	(1,062,492)	(6,978,680)	-
Component unit								
Downtown Development Authority								
Community and economic development	\$ 483,075	\$ 50,909	\$ 10,000	\$ -	-	-	-	(422,166)
General revenues								
Property taxes					2,139,942	-	2,139,942	297,744
Income taxes					1,016,829	-	1,016,829	-
Franchise fees					80,347	-	80,347	-
Grants and contributions not restricted to specific programs					1,836,180	-	1,836,180	-
Unrestricted investment earnings					28,354	173,453	201,807	9,439
Miscellaneous					335,297	-	335,297	54,228
Gain on sale of capital asset					15,858	-	15,858	-
Transfers					32,541	(32,541)	-	-
Total general revenues and transfers					5,485,348	140,912	5,626,260	361,411
Change in net assets					(430,840)	(921,580)	(1,352,420)	(60,755)
Net assets at January 1, 2005, as restated					8,785,245	10,956,564	19,741,809	365,499
Net assets at December 31, 2005					\$ 8,354,405	\$ 10,034,984	\$ 18,389,389	\$ 304,744

The accompanying notes are an integral part of this statement.

City of Muskegon Heights
BALANCE SHEET
 Governmental Funds
 December 31, 2005

	General Fund	Other governmental funds	Total governmental funds
ASSETS			
Cash and investments	\$ 101,551	\$ 664,642	\$ 766,193
Receivables			
Accounts	293,338	53,612	346,950
Property taxes	344,255	56,477	400,732
Income taxes	118,752	-	118,752
Special assessments	-	135,296	135,296
Due from other funds	392,563	145,187	537,750
Due from component unit	30,734	-	30,734
Due from other governmental units	324,936	281,593	606,529
Inventories	24,927	-	24,927
Prepaid items	200,539	-	200,539
Total assets	<u>\$ 1,831,595</u>	<u>\$ 1,336,807</u>	<u>\$ 3,168,402</u>
LIABILITIES AND FUND BALANCES (DEFICITS)			
Liabilities			
Accounts payable	\$ 332,956	\$ 94,322	\$ 427,278
Accrued liabilities	56,333	10,260	66,593
Due to other funds	37,842	332,810	370,652
Due to other governmental units	3,124	-	3,124
Deferred revenue	1,271,767	197,317	1,469,084
Total liabilities	1,702,022	634,709	2,336,731
Fund balances (deficits)			
Reserved for:			
Inventories	24,927	-	24,927
Prepaid items	200,539	-	200,539
Debt service	-	4,332	4,332
Capital projects	-	26,161	26,161
Nonexpendable perpetual care	-	511,378	511,378
Unreserved, undesignated, reported in			
General Fund	(95,893)	-	(95,893)
Special revenue funds	-	160,227	160,227
Total fund balances	129,573	702,098	831,671
Total liabilities and fund balances	<u>\$ 1,831,595</u>	<u>\$ 1,336,807</u>	<u>\$ 3,168,402</u>

The accompanying notes are an integral part of this statement.

City of Muskegon Heights
**RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET
 TO THE STATEMENT OF NET ASSETS**
 December 31, 2005

Total fund balance—governmental funds	\$	831,671
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Amounts reported for governmental activities in the Statement of Net Assets
are different because:

Inventory of houses recorded on the Statement of Net Assets that were recorded as grant expenditures in the governmental funds.		65,000
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Capital assets used in governmental activities are not financial resources and
are not reported in the governmental funds.

Cost of capital assets	\$ 23,393,294	
Accumulated depreciation	<u>(13,536,373)</u>	9,856,921

Bond issuance costs are not capitalized and amortized in the governmental funds.

Bond issuance costs	51,731	
Accumulated amortization	<u>(6,035)</u>	45,696

Other long-term receivables in governmental activities not reported in the
governmental funds.

266,885

Long-term liabilities in governmental activities are not due and payable in the current
period and are not reported in the governmental funds.

Bonds and notes payable	(2,283,345)	
Compensated absences	<u>(410,923)</u>	(2,694,268)

Accrued interest in governmental activities is not reported in the governmental funds.

(17,500)

Net assets of governmental activities in the Statement of Net Assets	\$	<u><u>8,354,405</u></u>
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The accompanying notes are an integral part of this statement.

City of Muskegon Heights
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES
Governmental Funds
For the year ended December 31, 2005

	General Fund	Other governmental funds	Total governmental funds
REVENUES			
Taxes	\$ 3,105,561	\$ 55,710	\$ 3,161,271
Licenses and permits	101,353	-	101,353
Intergovernmental revenues			
Federal	34,718	679,853	714,571
State	1,867,958	849,764	2,717,722
Charges for services	711,490	219,605	931,095
Fines and forfeitures	44,713	-	44,713
Investment earnings	15,348	12,991	28,339
Other	218,047	89,073	307,120
Total revenues	6,099,188	1,906,996	8,006,184
EXPENDITURES			
Current			
General government	1,998,180	173,573	2,171,753
Public safety	3,239,474	-	3,239,474
Public works	726,483	657,232	1,383,715
Community and economic development	5,875	366,304	372,179
Culture and recreation	194,098	137,869	331,967
Debt service			
Principal	28,534	92,888	121,422
Interest and fees	1,898	91,058	92,956
Capital outlay	85,668	358,309	443,977
Total expenditures	6,280,210	1,877,233	8,157,443
Excess of revenues over (under) expenditures	(181,022)	29,763	(151,259)
OTHER FINANCING SOURCES (USES)			
Proceeds from the sale of capital assets	18,012	-	18,012
Proceeds from long-term debt	65,816	10,200	76,016
Transfers in	51,157	163,305	214,462
Transfers out	(82,692)	(99,229)	(181,921)
Total other financing sources (uses)	52,293	74,276	126,569
Net change in fund balances	(128,729)	104,039	(24,690)
Fund balances at January 1, 2005, as restated	258,302	598,059	856,361
Fund balances at December 31, 2005	\$ 129,573	\$ 702,098	\$ 831,671

The accompanying notes are an integral part of this statement.

City of Muskegon Heights
**RECONCILIATION OF THE GOVERNMENTAL FUNDS STATEMENT OF REVENUES, EXPENDITURES
AND CHANGES IN FUND BALANCES TO THE STATEMENT OF ACTIVITIES**

For the year ended December 31, 2005

Net change in fund balances—total governmental funds	\$	(24,690)
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Amounts reported for governmental activities in the Statement of Activities are different because:

Revenues reported in the Statement of Activities that does not provide current financial resources are not reported as revenue in the governmental funds.		214,075
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Governmental funds report outlays for capital assets and bond issuance costs as expenditures; in the Statement of Activities, these costs are depreciated and amortized over their estimated useful lives, respectively.

Depreciation and amortization expense	\$ (1,102,594)	
Capital outlay	<u>462,795</u>	(639,799)

Debt proceeds are other financing sources in the governmental funds, but the proceeds increase long-term debt in the Statement of Net Assets.		(76,016)
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Governmental funds report the entire proceeds from the sale of capital assets as revenue, but the Statement of Activities reports only the gain or loss on sale of capital assets		(7,103)
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Repayment of principal on long-term debt is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the Statement of Net Assets.		121,422
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Interest expense on long-term debt is recorded in the statement of Activities when incurred but is not reported in the governmental funds until paid.		(5,320)
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Compensated absences are reported on the accrual method in the Statement of Activities when incurred, but is reported as expenditures when financial resources are used in the governmental funds.		<u>(13,409)</u>
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Change in net assets of governmental activities	\$	<u><u>(430,840)</u></u>
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The accompanying notes are an integral part of this statement.

City of Muskegon Heights
STATEMENT OF NET ASSETS
Proprietary Funds
December 31, 2005

ASSETS

	Business-type Activities - Enterprise funds			
	Sewer	Water	Water Supply	Total
CURRENT ASSETS				
Cash and investments	\$ 1,175,388	\$ 159,625	\$ 814,539	\$ 2,149,552
Accounts receivable	232,048	319,686	-	551,734
Due from other funds	33,627	-	394,666	428,293
Inventories	-	17,050	8,389	25,439
Total current assets	1,441,063	496,361	1,217,594	3,155,018
NONCURRENT ASSETS				
Restricted assets	-	-	3,385,109	3,385,109
Capital assets				
Land	2,246	-	37,766	40,012
Buildings and improvements	-	21,920	115,793	137,713
Plants and infrastructure	3,172,580	1,911,658	24,962,410	30,046,648
Machinery and equipment	200,124	233,050	380,747	813,921
Less accumulated depreciation	(1,949,759)	(1,675,193)	(5,526,969)	(9,151,921)
Net capital assets	1,425,191	491,435	19,969,747	21,886,373
Access rights, net	208,952	-	-	208,952
Bond issuance costs, net	-	-	406,790	406,790
Total noncurrent assets	1,634,143	491,435	23,761,646	25,887,224
Total assets	3,075,206	987,796	24,979,240	29,042,242

LIABILITIES AND NET ASSETS (DEFICIT)

CURRENT LIABILITIES				
Accounts payable	100,978	26,647	546,878	674,503
Accrued liabilities	12,633	8,660	139,773	161,066
Due to other funds	64,180	487,135	44,076	595,391
Deferred revenue	-	17,009	-	17,009
Bonds and other obligations, due within one year	187,837	-	410,000	597,837
Total current liabilities	365,628	539,451	1,140,727	2,045,806
NONCURRENT LIABILITIES				
Bonds and other obligations, less amounts due within one year	364,834	-	16,596,618	16,961,452
Total liabilities	730,462	539,451	17,737,345	19,007,258
NET ASSETS (DEFICIT)				
Invested in capital assets, net of related debt	1,081,472	491,435	4,270,675	5,843,582
Restricted for:				
Capital projects	-	-	417,118	417,118
Debt service	-	-	2,067,234	2,067,234
Unrestricted	1,263,272	(43,090)	486,868	1,707,050
Total net assets	\$ 2,344,744	\$ 448,345	\$ 7,241,895	\$ 10,034,984

The accompanying notes are an integral part of this statement.

City of Muskegon Heights
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN FUND NET ASSETS
 Proprietary Funds
 For the year ended December 31, 2005

	Business-type Activities - Enterprise funds			
	Sewer	Water	Water Supply	Total
REVENUES				
Charges for services	\$ 817,386	\$ 1,395,381	\$ 2,386,142	\$ 4,598,909
OPERATING EXPENSES				
Administration	83,004	126,803	80,000	289,807
Operations	738,844	1,273,235	1,336,832	3,348,911
Depreciation and amortization	50,056	43,726	725,722	819,504
Total operating expenses	871,904	1,443,764	2,142,554	4,458,222
Operating income (loss)	(54,518)	(48,383)	243,588	140,687
NONOPERATING REVENUES (EXPENSES)				
Investment earnings	26,215	1,677	145,561	173,453
Interest expense	(70,112)	-	(1,133,067)	(1,203,179)
Total nonoperating revenue (expenses)	(43,897)	1,677	(987,506)	(1,029,726)
Loss before transfers	(98,415)	(46,706)	(743,918)	(889,039)
Transfers in	-	179,576	-	179,576
Transfers out	-	-	(212,117)	(212,117)
Change in net assets	(98,415)	132,870	(956,035)	(921,580)
Net assets at January 1, 2005	2,443,159	315,475	8,197,930	10,956,564
Net assets at December 31, 2005	\$ 2,344,744	\$ 448,345	\$ 7,241,895	\$ 10,034,984

The accompanying notes are an integral part of this statement.

City of Muskegon Heights
STATEMENT OF CASH FLOWS
Proprietary Funds
For the year ended December 31, 2005

	Business-type Activities - Enterprise funds			
	Sewer	Water	Water Supply	Total
CASH FLOWS FROM OPERATING ACTIVITIES				
Receipts from customers	\$ 795,987	\$ 1,380,383	\$ 1,662,224	\$ 3,838,594
Receipts from interfund services provided	-	23,863	1,007,591	1,031,454
Payments to suppliers	(557,484)	(343,682)	(778,947)	(1,680,113)
Payments to employees	(151,484)	(237,872)	(552,372)	(941,728)
Payments for interfund services	(16,954)	(800,865)	(37,958)	(855,777)
Net cash provided by operating activities	70,065	21,827	1,300,538	1,392,430
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES				
Operating subsidies and transfers to other funds	47,445	(104,097)	(212,117)	(268,769)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES				
Proceeds from capital debt	-	-	595,000	595,000
Bond issuance costs and discounts	-	-	(472,191)	(472,191)
Purchases of capital assets	(28,888)	-	(353,060)	(381,948)
Principal paid on capital debt	(102,811)	-	(320,000)	(422,811)
Interest paid on capital debt	(70,112)	-	(1,171,823)	(1,241,935)
Net cash used for capital and related financing activities	(201,811)	-	(1,722,074)	(1,923,885)
CASH FLOW FROM INVESTING ACTIVITIES				
Investment earnings	26,215	1,677	145,561	173,453
Net decrease in cash and investments	(58,086)	(80,593)	(488,092)	(626,771)
Cash and investments at January 1, 2005	1,233,474	240,218	4,687,740	6,161,432
Cash and investments at December 31, 2005	<u>\$ 1,175,388</u>	<u>\$ 159,625</u>	<u>\$ 4,199,648</u>	<u>\$ 5,534,661</u>
Reconciliation of cash and investments to the balance sheet				
Cash and investments	\$ 1,175,388	\$ 159,625	\$ 814,539	\$ 2,149,552
Restricted assets	-	-	3,385,109	3,385,109
	<u>\$ 1,175,388</u>	<u>\$ 159,625</u>	<u>\$ 4,199,648</u>	<u>\$ 5,534,661</u>
Reconciliation of operating income (loss) to net cash provided by operating activities				
Operating income (loss)	\$ (54,518)	\$ (48,383)	\$ 243,588	\$ 140,687
Adjustments to reconcile operating income (loss) to net cash provided by operating activities				
Depreciation and amortization expense	52,085	43,726	725,722	821,533
Change in assets and liabilities				
Receivables, net	(21,399)	33,090	-	11,691
Internal activity	63,046	3,053	325,715	391,814
Inventories	-	-	(893)	(893)
Accounts payable	33,443	20,790	(1,283)	52,950
Accrued liabilities	(2,592)	(30,449)	7,689	(25,352)
Net cash provided by operating activities	<u>\$ 70,065</u>	<u>\$ 21,827</u>	<u>\$ 1,300,538</u>	<u>\$ 1,392,430</u>
Noncash financing activities				
Assumption of additional County debt	\$ -	\$ -	\$ 210,981	\$ 210,981
Refunded bonds	-	-	6,255,000	6,255,000

The accompanying notes are an integral part of this statement.

City of Muskegon Heights
STATEMENT OF FIDUCIARY NET ASSETS

Fiduciary Funds
December 31, 2005

	Private Purpose Trust Fund - John Hendrick Flower fund	Agency Funds
	<u> </u>	<u> </u>
ASSETS		
Cash and investments	\$ 3,169	\$ 724,456
	<u> </u>	<u> </u>
LIABILITIES		
Accounts payable	-	127,055
Due to other governmental units	-	563,779
Deposits held for others	<u> </u>	<u> </u>
	-	33,622
Total liabilities	<u> </u>	<u> </u>
	-	724,456
NET ASSETS		
Held in trust for benefits and other purposes	\$ 3,169	\$ -
	<u> </u>	<u> </u>

The accompanying notes are an integral part of this statement.

City of Muskegon Heights
STATEMENT OF CHANGES IN FIDUCIARY NET ASSETS
Fiduciary Fund
For the year ended December 31, 2005

	Private Purpose Trust Fund - John Hendrick Flower fund
	<hr/>
ADDITIONS	\$ -
DEDUCTIONS	
Fees	<hr/> 46
Change in net assets	(46)
Net assets at January 1, 2005	<hr/> 3,215
Net assets at December 31, 2005	<hr/> <hr/> \$ 3,169

The accompanying notes are an integral part of this statement.

City of Muskegon Heights
NOTES TO FINANCIAL STATEMENTS
December 31, 2005

NOTE A—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements of the City of Muskegon Heights (City) have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as applied to government units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The more significant of the City's accounting policies are described below.

Report Entity

The City is a municipal corporation governed by an elected mayor and six-member council and is administered by a city manager appointed by the City Council. The accompanying financial statements present the government and its component unit, an entity for which the government is considered to be financially accountable. The discretely presented component unit is reported in a separate column in the government-wide financial statements (see note below for description) to emphasize that it is legally separate from the government. The discretely presented component unit has a December 31 fiscal year.

Discretely presented component unit

The Downtown Development Authority (DDA) board is appointed by the City Council, but the DDA operates as a separate entity. The DDA board can authorize and issue debt independent from the City. The DDA is presented as a governmental fund type.

Government-Wide and Fund Financial Statements

The government-wide financial statements (i.e., the statement of net assets and the statement of changes in net assets) report information on all of the nonfiduciary activities of the primary government and its component units. Governmental activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support. Likewise, the primary government is reported separately from certain legally separate component units for which the primary government is financially accountable.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function or segment. Program revenues include 1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment and 2) grants and contributions that are restricted to meeting the operational or capital requirement of a particular function or segment. Taxes and other items not properly included among program revenues are reported instead as general revenues. The City does not allocate indirect costs.

Separate financial statements are provided for governmental funds, proprietary funds, and fiduciary funds, even though the latter are excluded from the government-wide financial statements. Major individual governmental funds and major individual enterprise funds are reported as separate columns in the fund financial statements.

City of Muskegon Heights
NOTES TO FINANCIAL STATEMENTS—CONTINUED
December 31, 2005

NOTE A—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES—Continued

Measurement Focus, Basis of Accounting and Financial Statement Presentation

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting, as are the proprietary fund and fiduciary fund financial statements. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the government considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences and claims and judgments, are recorded only when payment is due.

Property taxes, income taxes, franchise taxes, licenses and interest associated with the current fiscal period are all considered to be susceptible to accrual and so have been recognized as revenues of the current fiscal period. Only the portion of special assessments receivable due within the current fiscal period is considered to be susceptible to accrual as revenue of the current period. All other revenue items are considered to be measurable and available only when cash is received by the government.

The City reports the following major governmental funds:

The General Fund is the government's primary operating fund. It accounts for all financial resources of the general government, except those required to be accounted for in another fund.

The City reports the following three major proprietary funds:

The Sewer Fund operates the City's sewage pumping station, collection systems and pays for access to the county's sewage treatment plant.

The Water Fund operates the City's water distribution system.

The Water Supply Fund operates the City's water treatment plant. The plant provides water to the City and two adjacent municipalities.

Additionally, the City reports the following fund types:

The Private Purpose Trust Fund is a fund comprised of employee contributions for the purpose of purchasing cards and flowers as sympathy for illness and death.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in both the government-wide and proprietary fund financial statements to the extent that those standards do not conflict with or contradict guidance of the Government Accounting Standards Board. Governments also have the option of following subsequent private-sector guidance for their business-type activities and enterprise funds, subject to this same limitation. The City has elected not to follow subsequent private-sector guidance.

City of Muskegon Heights
NOTES TO FINANCIAL STATEMENTS—CONTINUED
December 31, 2005

NOTE A—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES—Continued

Measurement Focus, Basis of Accounting and Financial Statement Presentation—continued

As a general rule the effect of interfund activity has been eliminated from the government-wide financial statements. Exceptions to this general rule are payments-in-lieu of taxes and other charges between the City's water, sewer and water supply function and various other functions of the government. Elimination of these charges would distort the direct costs and program revenues reported for the various functions concerned.

Amounts reported as program revenues include 1) charges to customers or applicants for goods, services or privileges provided, 2) operating grants and contributions and 3) capital grants and contributions, including special assessments. Internally dedicated resources are reported as general revenues rather than as program revenues. Likewise, general revenues include all taxes.

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues are charges to customers for sales and services. The enterprise funds also recognize as operating revenue the portion of tap fees intended to recover the cost of connecting new customers to the system. Operating expenses for enterprise funds include the cost of sales and services, administrative expenses and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

When both restricted and unrestricted resources are available for use, it is the City's policy to use restricted resources first, then unrestricted resources as they are needed.

Assets, Liabilities and Net Assets or Equity

Deposits and Investments

The City's cash and cash equivalents are considered to be cash on hand, demand deposits and short-term investments with original maturities of three months or less from the date of acquisition.

The City reports its investments in accordance with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*. Under this standard, certain investments are valued at fair value as determined by quoted market prices or by estimated fair values when quoted market prices are not available. The standard also provides that certain investments are valued at cost (or amortized cost) when they are of a short-term duration, the rate of return is fixed, and the City intends to hold the investment until maturity.

The City has adopted an investment policy in compliance with State of Michigan statutes. Those statutes authorize the City to invest in obligations of the United States, certificates of deposit, prime commercial paper, securities guaranteed by United States agencies or instrumentalities, United States government or federal agency obligation repurchase agreements, bankers acceptances, state-approved investment pools and certain mutual funds.

The component unit's cash and investments are maintained within the City's investment pool.

City of Muskegon Heights
NOTES TO FINANCIAL STATEMENTS—CONTINUED
December 31, 2005

NOTE A—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES—Continued

Assets, Liabilities and Net Assets or Equity—Continued

Receivables and Payables

Activity between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either "due to/from other funds" (i.e., the current portion of interfund loans) or "advances to/from other funds" (i.e., the non-current portion of interfund loans). All other outstanding balances between funds are reported as "due to/from other funds". Any residual balances outstanding between the governmental activities and business-type activities are reported in the government-wide financial statements as "internal balances".

Advances between funds, as reported in the fund financial statements, are offset by a fund balance reserve account in applicable governmental funds to indicate that they are not available for appropriation and are not expendable available financial resources.

All trade and property tax receivables are shown net of allowance for uncollectibles.

The City bills and collects its own property taxes and also collects taxes for the county, school and State of Michigan. Taxes are levied on each July 1 on the taxable valuation of property (as defined by state statutes) located in the Local Governmental Unit as of the preceding December 31. Uncollectible real property taxes as of the following February 15 are turned over by the City to the County for collection. The County advances the City all these delinquent real property taxes. The delinquent personal property taxes remain the responsibility of the City.

Although the Local Governmental Unit 2005 ad valorem tax is levied and collectible on July 1, 2005, it is the Local Governmental Unit's policy to recognize one half of the current tax levy, if available, in the current year since the millage was approved to finance the City from July 1 through the following June 30. "Available" means collected within the current period or expected to be collected soon enough thereafter to be used to pay liabilities of the current period (60 days).

The 2005 state taxable value for real/personal property of the City totaled approximately \$123,900,000 of which approximately \$10,900,000 was captured by the DDA. The ad valorem taxes levied consisted of 13.35 mills for operation, 3 mills for sanitation, 2 mills for debt service for the City's General Fund operating purposes and .5 mills for the Recreation Fund activities. These amounts are recognized in the respective General Fund and Recreation Fund with the captured amount shown in the DDA component unit.

Inventories and Prepaid Items

All inventories are valued at cost using the first-in/first-out (FIFO) method. Inventories of governmental funds are recorded as expenditures when consumed rather than when purchased.

Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid items in both government-wide and fund financial statements.

Restricted Assets

Certain proceeds of the Enterprise Fund revenue bonds, as well as certain resources set aside for their repayment, are classified as restricted assets on the balance sheet because they are maintained in separate bank accounts and their use is limited by applicable bond covenants.

City of Muskegon Heights
NOTES TO FINANCIAL STATEMENTS—CONTINUED
December 31, 2005

NOTE A—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES—Continued

Assets, Liabilities and Net Assets or Equity—Continued

Capital Assets

Capital assets, which include property, plant, equipment and infrastructure assets (e.g., roads, bridges, sidewalks and similar items), are reported in the applicable governmental or business-type activities columns in the government-wide financial statements. Capital assets, including infrastructure assets, are defined by the government as assets with an initial, individual cost of more than \$5,000 and an estimated useful life in excess of two years. Such assets are recorded at historical costs or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value on date of donation.

The cost of normal maintenance and repairs that do not add to the value of the assets or materially extend lives are not capitalized.

Major outlays for capital assets and improvements are capitalized as projects are constructed. Interest incurred during the construction phase of capital assets of business-type activities is included as part of the capitalized value of the assets constructed.

In the case of the initial capitalization of general infrastructure assets (i.e., those reported by governmental activities) the government chose to include all such items regardless of their acquisition date or amount. The government was able to estimate the historical cost for the initial reporting of these assets through backtrending (i.e., estimating the current replacement cost of the infrastructure to be capitalized and using an appropriate price-level index to deflate the cost to the acquisition year or estimated acquisition year).

Property, plant and equipment of the primary government, as well as the component unit, is depreciated using the straight-line method over the following estimated useful lives:

<u>Assets</u>	<u>Years</u>
Buildings and improvements	25-50
Infrastructure	20-30
Plants and infrastructure	10-100
Machinery and equipment	5-25
Furniture and equipment	5
Vehicles	5-20

Compensated Absences

City employees are granted vacation and sick leave in varying amounts based on length of service. Accumulated vacation leave must be taken no later than the year after it is earned. Upon termination, employees are paid for unused vacation at their current rates. Sick leave is accumulated at the rate of one day per month of employment. Unused sick leave is accumulated up to 120 days for employees. Unused accumulated sick leave is paid to employees who resign or retire, limited to 50 percent of days accumulated. All vacation and sick pay is accrued when incurred in the government-wide and proprietary fund financial statements. The current portion of this liability is estimated based upon historic trends. A liability for these amounts is reported in governmental funds only if they have matured, for example, as a result of employee resignations and retirements.

City of Muskegon Heights
NOTES TO FINANCIAL STATEMENTS—CONTINUED
December 31, 2005

NOTE A—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES—Continued

Assets, Liabilities and Net Assets or Equity—Continued

Long-Term Obligations

In the government-wide financial statements and proprietary fund types in the fund financial statements, long-term debt and other long-term obligations are reported as liabilities in the applicable governmental activities, business-type activities or proprietary fund type statement of net assets. Bond premiums and discounts as well as issuance costs, are deferred and amortized over the life of the bonds using the effective interest method. Bonds payable are reported net of the applicable bond premium or discount. Bond issuance costs are reported as deferred charges and amortized over the term of the related debt.

In the fund financial statements, governmental fund types recognize bond premiums and discounts, as well as bond issuance costs, during the current period. The face amount of debt issued is reported as other financing sources. Premiums received on debt issuances are reported as other financing sources while discounts on debt issuances are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

Fund Equity

In the fund financial statements, governmental funds report reservations of fund balance for amounts that are not available for appropriation or are legally restricted by outside parties for use for a specific purpose. Designations of fund balance represent tentative management plans that are subject to change.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures.

NOTE B—STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

Budgetary Information

Annual budgets are adopted on a basis consistent with generally accepted accounting principles for all governmental funds except for the permanent fund, which is not budgeted. All annual appropriations lapse at fiscal year end.

The City follows these procedures in establishing the budgetary information provided in the financial statements:

- a. Prior to the first Monday of November, the City Manager submits to the City Council a proposed operating budget for the fiscal year commencing the following January 1. The operating budget includes proposed expenditures and the means of financing them.
- b. Public hearings are conducted at the City Hall to obtain taxpayer comments.
- c. Not later than the second Monday in December, the budget is legally enacted through passage of a resolution.
- d. Supplemental appropriations, when required to provide for additional expenditures, are matched by additional anticipated revenues or an appropriation of available fund balance and must be approved by the City Council. All appropriations lapse at year end.

The appropriated budget is prepared by fund, function and department. The City's department heads may make transfers of appropriations within a department. Transfers of appropriations between departments require the approval of the City Council. The legal level of budgetary control is the department level. The City Council made several supplemental budgetary appropriations throughout the year.

City of Muskegon Heights
NOTES TO FINANCIAL STATEMENTS—CONTINUED
December 31, 2005

NOTE B—STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY—Continued

Excess of Expenditures Over Appropriations

For the year ended December 31, 2005, actual expenditures exceeded appropriations in the following funds and departments.

	Amended budget	Actual
General Fund		
General government		
City Council	\$ 42,506	\$ 47,954
Personnel	8,500	9,404
Elections	10,000	10,118
Assessor	134,903	139,855
City clerk	65,200	67,130
Finance	126,500	134,563
Centennial Celebration	-	700
Building and grounds	159,800	169,685
Other general government	879,734	915,238
Motor pool	65,000	72,898
Public works		
Public works	57,000	69,481
Culture and recreation		
Parks	143,922	163,289
Library	27,000	29,130
Debt service		
Principal	14,101	28,534
Capital outlay	14,500	85,668
Transfers out	40,266	82,692
Major Streets Fund		
Routine maintenance	159,819	190,909
Traffic	64,440	70,035
Winter maintenance	126,850	159,516
Capital outlay	115,175	338,921
Debt service		
Principal	-	14,320
Interest	-	4,371
Local Streets Fund		
Winter maintenance	58,300	69,854
Recreation Fund	132,677	138,526
Cemetery Fund	174,673	184,626
Community Development Block Grant Fund	-	459,853

City of Muskegon Heights
NOTES TO FINANCIAL STATEMENTS—CONTINUED
December 31, 2005

NOTE B—STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY—Continued

Fund Deficit

As of December 31, 2005, the City's General Fund, Major Street Fund, Cemetery Fund and Water Fund had undesignated fund deficits of \$95,893, \$74,264, \$5,008, and \$43,090, respectively. The deficits will be eliminated through future operations, which may include new revenue sources, reduction of operating expenses and interfund transfers.

NOTE C—DEPOSITS AND INVESTMENTS

As of December 31, 2005, the City had the following investments:

Investment Type	<u>Fair value</u>	<u>Weighted average maturity (Months)</u>	<u>Moody's</u>	<u>Percent</u>
Money market mutual fund	\$ 109,240	1	AAA	1.9 %
External investment pool	4,109,942	1	not rated	71.1
Negotiable certificates of deposit	395,864	40	not rated	6.8
U.S. Treasury bonds	45,000	16	n/a	0.8
Federal agency bonds	1,092,791	88	AAA	18.9
Mortgage backed securities	<u>29,346</u>	<u>79</u>	AAA	<u>0.5</u>
Total fair value	<u>\$ 5,782,183</u>			<u>100.0 %</u>
Portfolio weighted average maturity		<u>21</u>		

The City voluntarily invests certain excess funds in an external pooled investment pool (Pool). The Pool is an external investment pool of "qualified" investments for Michigan municipalities. The Pool is not regulated nor registered with the SEC. The fair value of the City's investments is the same as the fair value of the Pool.

Interest rate risk. The City does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

Credit risk. State law limits investments in commercial paper and corporate bonds to the two highest classifications issued by nationally recognized statistical rating organizations (NRSROs). The City has no investment policy that would further limit its investment choices.

Concentration of credit risk. The City does not have a concentration of credit risk policy. Concentration of credit risk is the risk of loss attributed to the magnitude of the City investment in a single issuer, by diversifying the investment portfolio so that the impact of potential losses from any one type of security or issuer will be minimized. More than 5 percent of the City's investments are in bonds issued by the Federal Home Loan Bank. These investments represent 15.5 percent of the City's investments.

City of Muskegon Heights
NOTES TO FINANCIAL STATEMENTS—CONTINUED
December 31, 2005

NOTE C—DEPOSITS AND INVESTMENTS—CONTINUED

Custodial credit risk - deposits. In the case of deposits, this is the risk that in the event of a bank failure, the City's deposits may not be returned to it. As of December 31, 2005, \$1,480,943 of the City's bank balance of \$1,880,943 was exposed to custodial credit risk because it was uninsured and uncollateralized.

Custodial credit risk - investments. The City does not have a custodial credit risk policy for investments. This is the risk that, in the event of the failure of the counterparty, the City will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party.

Foreign currency risk. The City is not authorized to invest in investments which have this type of risk.

Restricted Assets

Restrictions are placed on assets by bond ordinance and City Council action. At December 31, 2005, restricted cash and investments in the enterprise funds are restricted as follows:

Water Supply Fund	
Rate Stabilization	\$ 294,477
Repairs and Replacement	417,118
Bond Reserve Fund	1,772,757
Construction	<u>900,757</u>
	<u>\$ 3,385,109</u>

NOTE D—CAPITAL ASSETS

Capital asset activity for the year ended December 31, 2005 was as follows:

	Balance January 1, 2005	Additions	Deductions	Balance December 31, 2005
Governmental activities:				
Capital assets, not being depreciated:				
Land	\$ 254,408	\$ -	\$ -	\$ 254,408
Capital assets, being depreciated:				
Buildings and improvements	1,235,756	-	-	1,235,756
Infrastructure	18,198,936	356,990	152,263	18,403,663
Furniture and equipment	1,326,662	38,236	-	1,364,898
Vehicles	<u>2,088,543</u>	<u>67,569</u>	<u>21,542</u>	<u>2,134,570</u>
Total capital assets, being depreciated	22,849,897	462,795	173,805	23,138,887

City of Muskegon Heights
NOTES TO FINANCIAL STATEMENTS—CONTINUED
December 31, 2005

NOTE D—CAPITAL ASSETS—Continued

	Balance January 1, 2005	Additions	Deductions	Balance December 31, 2005
Governmental activities:—Continued				
Less accumulated depreciation:				
Buildings and improvements	\$ 543,091	\$ 25,705	\$ -	\$ 568,796
Infrastructure	10,546,851	899,676	147,314	11,299,213
Furniture and equipment	444,962	77,167	-	522,129
Vehicles	1,070,750	94,874	19,388	1,146,236
Total accumulated depreciation	<u>12,605,654</u>	<u>1,097,422</u>	<u>166,702</u>	<u>13,536,374</u>
Total capital assets, being depreciated, net	<u>10,244,243</u>	<u>(634,627)</u>	<u>7,103</u>	<u>9,602,513</u>
Capital assets, net	<u><u>\$ 10,498,651</u></u>	<u><u>\$ (634,627)</u></u>	<u><u>\$ 7,103</u></u>	<u><u>\$ 9,856,921</u></u>
Business-type activities:				
Capital assets, not being depreciated:				
Land	\$ 40,012	\$ -	\$ -	\$ 40,012
Capital assets, being depreciated:				
Buildings and improvements	111,226	112,600	86,113	137,713
Plants and infrastructure	29,835,487	211,161	-	30,046,648
Machinery and equipment	844,234	58,187	88,500	813,921
Total capital assets, being depreciated	<u>30,790,947</u>	<u>381,948</u>	<u>174,613</u>	<u>30,998,282</u>
Less accumulated depreciation:				
Buildings and improvements	111,226	4,223	86,113	29,336
Plants and infrastructure	7,580,317	800,044	-	8,380,361
Machinery and equipment	815,487	15,237	88,500	742,224
Total accumulated depreciation	<u>8,507,030</u>	<u>819,504</u>	<u>174,613</u>	<u>9,151,921</u>
Total capital assets, being depreciated, net	<u>22,283,917</u>	<u>(437,556)</u>	<u>-</u>	<u>21,846,361</u>
Capital assets, net	<u><u>\$ 22,323,929</u></u>	<u><u>\$ (437,556)</u></u>	<u><u>\$ -</u></u>	<u><u>\$ 21,886,373</u></u>

City of Muskegon Heights
NOTES TO FINANCIAL STATEMENTS—CONTINUED
December 31, 2005

NOTE D—CAPITAL ASSETS—Continued

Depreciation

Depreciation expense has been charged to functions as follows:

Governmental activities:

General government	\$ 28,179
Public safety	77,634
Public works	971,332
Culture and recreation	<u>20,277</u>
	<u>\$ 1,097,422</u>

Business-type activities:

Sewer	\$ 50,056
Water	43,726
Water supply	<u>725,722</u>
	<u>\$ 819,504</u>

Component unit:	<u>Balance January 1, 2005</u>	<u>Additions</u>	<u>Deductions</u>	<u>Balance December 31, 2005</u>
Capital assets, not being depreciated:				
Land	\$ 294,635	\$ -	\$ -	\$ 294,635
Capital assets, being depreciated:				
Building	753,835	-	-	753,835
Less accumulated depreciation:				
Buildings	<u>137,237</u>	<u>17,126</u>	<u>-</u>	<u>154,363</u>
Total capital assets, being depreciated, net	<u>616,598</u>	<u>(17,126)</u>	<u>-</u>	<u>599,472</u>
Capital assets, net	<u>\$ 911,233</u>	<u>\$ (17,126)</u>	<u>\$ -</u>	<u>\$ 894,107</u>

Depreciation expense has been charged to community and economic development.

City of Muskegon Heights
NOTES TO FINANCIAL STATEMENTS—CONTINUED
December 31, 2005

NOTE E—ACCESS RIGHTS

Access rights activity for the year ended December 31, 2005 was as follows:

	Balance January 1, 2005	Additions	Deductions	Balance December 31, 2005
Business-type activities				
Access rights	\$ -	\$ 210,981	\$ -	\$ 210,981
Less accumulated amortization	-	2,029	-	2,029
Access rights, net	\$ -	\$ 208,952	\$ -	\$ 208,952

Amortization

Amortization expense has been charged to sewer.

NOTE F—BOND ISSUANCE COSTS

Bond issuance cost activity for the year ended December 31, 2005 was as follows:

	Balance January 1, 2005	Additions	Deductions	Balance December 31, 2005
Business-type activities				
Bond issuance costs	\$ 383,180	\$ 209,964	\$ 126,450	\$ 466,694
Less accumulated amortization	76,636	12,773	29,505	59,904
Bond issuance costs, net	\$ 306,544	\$ 197,191	\$ 96,945	\$ 406,790

Amortization

Amortization expense has been charged to interest in the water supply fund.

NOTE G—INTERFUND RECEIVABLES, PAYABLES AND TRANSFERS

The composition of interfund balances as of December 31, 2005 is as follows:

Due to/from other funds:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
General Fund	Other governmental funds	\$ 225,465
General Fund	Sewer Fund	64,180
General Fund	Water Fund	58,842
General Fund	Water Supply Fund	44,076

City of Muskegon Heights
NOTES TO FINANCIAL STATEMENTS—CONTINUED
December 31, 2005

NOTE G—INTERFUND RECEIVABLES, PAYABLES AND TRANSFERS—Continued

Due to/from other funds:—Continued

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
Other governmental funds	General Fund	\$ 37,842
Other governmental funds	Other governmental funds	107,345
Sewer Fund	Water Fund	33,627
Water Supply Fund	Water Fund	394,666
		<u>\$ 966,043</u>

Advances from/to primary government and component unit:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
General Fund	Component unit	\$ 30,734

The outstanding balances between funds result mainly from the time lag between the dates that (1) interfund goods and services are provided or reimbursable expenditures occur, (2) transactions are recorded in the accounting system, and (3) payments between funds are made.

Interfund transfers:

	<u>Transfers in:</u>			<u>Total</u>	<u>Purpose</u>
	<u>General Fund</u>	<u>Other governmental funds</u>	<u>Water Fund</u>		
Transfers out:					
General Fund	\$ -	\$ 82,692	\$ -	\$ 82,692	Debt service
Other governmental funds	51,157	48,072	-	99,229	Operations and debt service
Water Supply Fund	-	32,541	179,576	212,117	Public works
	<u>\$ 51,157</u>	<u>\$ 163,305</u>	<u>\$ 179,576</u>	<u>\$ 394,038</u>	

City of Muskegon Heights
NOTES TO FINANCIAL STATEMENTS—CONTINUED
December 31, 2005

NOTE H—DEFERRED REVENUE

Governmental funds report deferred revenue in connection with receivables for revenues that are not considered to be available to liquidate liabilities of the current period. Governmental funds also defer revenue recognition in connection with resources that have been received, but not yet earned. At the end of the current fiscal year, the various components of deferred revenue reported in the governmental funds were as follows:

	City		Downtown Development Authority	
	Unavailable	Unearned	Unavailable	Unearned
Property taxes	\$ 432,734	\$ 666,310	\$ -	\$ 166,224
Special assessments not yet due	135,295	-	-	-
Receivables	164,590	70,155	-	-
Total deferred revenue for governmental funds	<u>\$ 732,619</u>	<u>\$ 736,465</u>	<u>\$ -</u>	<u>\$ 166,224</u>

NOTE I—LEASES

The City leases equipment under noncancelable operating leases. Total costs for such leases were approximately \$14,200 for the year ended December 31, 2005. The future minimum lease payments for these leases are as follows:

<u>December 31,</u>	<u>Amount</u>
2006	\$ 13,600
2007	13,600
2008	200
	<u>\$ 27,400</u>

NOTE J—LONG-TERM DEBT

Summary of Changes in Long-Term Liabilities

The following is a summary of long-term liabilities activity for the City for the year ended December 31, 2005.

	Balance January 1, 2005	Additions	Reductions	Balance December 31, 2005	Due within one year
Governmental activities:					
General obligation bonds	\$ 2,165,000	\$ -	\$ 20,000	\$ 2,145,000	\$ 190,000
Installment purchase agreements	95,475	38,235	73,822	59,888	23,613

City of Muskegon Heights
NOTES TO FINANCIAL STATEMENTS—CONTINUED
December 31, 2005

NOTE J—LONG-TERM DEBT—Continued

Summary of Changes in Long-Term Liabilities—Continued

	Balance January 1, 2005	Additions	Reductions	Balance December 31, 2005	Due within one year
Governmental activities:—Continued					
Capital leases	\$ 68,277	\$ 37,781	\$ 27,600	\$ 78,458	\$ 27,310
Compensated absences	397,514	233,312	219,904	410,922	100,000
Governmental activity long-term liabilities	\$ 2,726,266	\$ 309,328	\$ 341,326	\$ 2,694,268	\$ 340,923
Business-type activities:					
Revenue bonds	\$ 17,548,064	\$ 6,593,674	\$ 6,582,449	\$ 17,559,289	\$ 597,837
Downtown Development Authority:					
General obligation bonds	\$ 660,000	\$ -	\$ -	\$ 660,000	\$ 50,000
Installment purchase agreements	158,120	-	19,951	138,169	20,446
Downtown Development Authority long-term liabilities	\$ 818,120	\$ -	\$ 19,951	\$ 798,169	\$ 70,446

Governmental activities:

General obligation bonds:

Michigan Municipal Bond Authority,
2004 Financial Stabilization Bonds, due in varying
annual installments of \$170,000 to \$210,000 from
November 2006 through November 2013, plus interest
at 2.5% to 4% \$ 1,500,000

Michigan Municipal Bond Authority,
Series 1997C, Advance Refunding of Series 1991C,
Group B of 1991 bonds, due in varying annual
installments of \$20,000 to \$75,000 through November
2020, plus interest at 7.2% 645,000

City of Muskegon Heights
NOTES TO FINANCIAL STATEMENTS—CONTINUED
December 31, 2005

NOTE J—LONG-TERM DEBT—Continued

Summary of Changes in Long-Term Liabilities—Continued

Governmental activities:—Continued

Installment purchase agreements:

3.75% Equipment note payable in current semi-annual payments of \$4,982 including interest; final payment due March 2008	\$ 23,535
4.25% Equipment note payable in current monthly installments of \$1,014 including interest; final payment due April 2008	26,967
6.25% Equipment note payable in current quarterly installments of \$936 including interest; final payment due September 2008	9,386

Capital leases:

6.94% Capital lease payable in quarterly installments of \$4,673 including interest; final payment due March 2009	53,957
4.25% Capital lease payable in monthly installments of \$1,104 including interest; final payment due March 2009	24,501

2,283,346

Compensated absences 410,922

\$ 2,694,268

Business-type activities:

Revenue bonds:

Water Supply System revenue bonds of 2000 due in annual installments of \$310,000 to \$720,000 through November 2030; plus interest at rates varying from 5.2% to 6.0%	\$ 10,795,000
Less issuance discount	(171,075)
Water Supply System revenue refunding bonds of 2005 due in annual installments of \$185,000 to \$495,000 through November 2030; plus interest at rates varying from 5.2% to 5.625%	6,850,000
Less issuance discount	(83,625)
Less deferred amount on refunding	(383,682)

City of Muskegon Heights
NOTES TO FINANCIAL STATEMENTS—CONTINUED
December 31, 2005

NOTE J—LONG-TERM DEBT—Continued

Summary of Changes in Long-Term Liabilities—Continued

Business-type activities:

Revenue bonds:

Muskegon County Wastewater Management System No. 1 bond refunding contractual obligation of 1996 final payment due July 2005; plus interest at 5.7%	\$ 416,158
\$1,615,250 Muskegon County Wastewater Management contract payable beginning in 2008; interest at 1.625%	<u>136,513</u>
	<u>\$ 17,559,289</u>

Downtown Development Authority:

General obligation bond:

\$995,000 Downtown Development limited tax obligation bonds of 1994 due in annual installments of \$50,000 to \$125,000 starting May 2006 through May 2012; plus interest at rates varying from 7.0% to 7.25%	\$ 660,000
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Installment purchase agreements:

Mortgage note payable to bank due in monthly installments of \$2,668 through January 2011; including interest at 9.20%	<u>138,169</u>
	<u>\$ 798,169</u>

For governmental activities, claims and judgments and compensated absences are generally liquidated by the General Fund.

The Downtown Development Authority general obligation bonds are backed by the full faith and credit of the City.

The County of Muskegon wastewater contracts payable represent agreements with Muskegon County relating to the construction of sewage treatment facilities. To construct these facilities, the County issued bonds which local municipalities are obligated to repay. The City has recorded the liability for its portion of the County bonds which are to be repaid by the access rights fee. Access rights are also recorded and are amortized over 20 years. The contractual obligation is secured by the full faith and credit of the City. Current debt service requirements are funded by sewer revenues.

The City was in compliance in all material respects with all the revenue bond ordinances at December 31, 2005.

City of Muskegon Heights
NOTES TO FINANCIAL STATEMENTS—CONTINUED
December 31, 2005

NOTE J—LONG-TERM DEBT—Continued

In December 2005, the City issued \$6.85 million in Water Supply System Revenue Bonds with interest rates from 3.3 to 4.5 percent to partially advance refund \$6.255 million of outstanding 2000 Water Supply System Revenue Bonds with interest rate from 5.2 to 6.0 percent. The net proceeds of approximately \$6.550 million (after payment of \$293 thousand in underwriting fees, insurance and other issuance costs) including \$82 thousand of 2000 Water Supply System Bond reserve fund monies were used to purchase U.S. government securities. Those securities were deposited in an irrevocable trust with an escrow agent to provide for principal redemption and interest of 2000 Water Supply System Revenue Bonds which are scheduled for maturity May 2006 and beyond. As a result, the 2000 Water Supply System Revenue Bonds are considered to be partially defeased and the liability for those bonds has been removed from long-term obligations.

The City advance refunded the 2000 Water Supply System Revenue Bonds to reduce its total debt service payment over the next 25 years by over \$850 thousand and to obtain an economic gain (difference between the present values of the debt service payments on the old and new debt) of over \$464 thousand.

In January 2006, the City advance refunded an additional portion of the 2000 Water Supply System Revenue Bonds to reduce its total debt service payment over the next 25 years by over \$1.2 million and to obtain an economic gain (difference between the present values of the debt service payments on the old and new debt) of over \$682 thousand.

Effective January 2005, the wastewater service agreement between the County of Muskegon and thirteen local units, including the City of Muskegon Heights was amended to provide financial relief to the County's largest industrial user. Under terms of the amendment, the debt allocated to each local unit user will increase. The Sewer Fund's total debt obligation and annual payments on that obligation will increase by about 21 percent. The financial impact on the City in 2005 was about \$75,000. This bond will be fully retired in 2008. Additional County wastewater debt is paid by local unit users through user charges based on metered sewage flows. Payments on these issues will increase for all local units, including the City. The financial impact on the City in 2005 was about \$84,000.

Annual debt service requirements to maturity for debt outstanding as of December 31, 2005 follows:

Year ending December 31,	Governmental activities		Business-type activities		Component unit	
	Principal	Interest	Principal	Interest	Principal	Interest
2006	\$ 240,874	\$ 96,247	\$ 597,837	\$ 852,344	\$ 70,446	\$ 55,215
2007	253,681	87,179	509,573	864,188	99,345	49,708
2008	229,211	78,551	523,748	841,225	111,352	42,020
2009	219,580	71,051	435,000	814,847	128,525	33,229
2010	220,000	63,675	455,000	792,796	130,878	23,677
2011-2015	810,000	186,046	2,761,513	3,627,933	257,623	19,124
2016-2020	310,000	50,721	3,325,000	2,928,160	-	-
2021-2025	-	-	4,210,000	2,027,185	-	-
2026-2030	-	-	5,380,000	859,051	-	-
	<u>\$ 2,283,346</u>	<u>\$ 633,470</u>	<u>\$ 18,197,671</u>	<u>\$ 13,607,729</u>	<u>\$ 798,169</u>	<u>\$ 222,973</u>

City of Muskegon Heights
NOTES TO FINANCIAL STATEMENTS—CONTINUED
December 31, 2005

NOTE K—OTHER INFORMATION

Risk Management

The City is exposed to various risks of loss related to torts; theft of, damage to and destruction of assets; errors and omissions; and natural disasters for which the government carries commercial insurance. Liabilities are reported when it is probable that a loss has occurred and the amount of the loss in excess of insurance coverage can be reasonably estimated. There has been no loss in excess of insurance in the past three years.

Contingent Liabilities

Amounts received or receivable from grant agencies are subject to audit and adjustment by grantor agencies, principally the federal government. Any disallowed claims, including amounts already collected, may constitute a liability to the applicable funds. The amount, if any, of expenditures that may be disallowed by the grantor cannot be determined at this time, although the City expects such amounts, if any, to be immaterial.

The City is a defendant in various lawsuits. Although the outcome of these lawsuits is not presently determinable, in the opinion of the City's counsel the resolution of these matters will not have a material adverse effect on the financial condition of the City.

Post-Retirement Health Care

The City has agreed to provide post-retirement health care to certain full-time employees after they reach age 50 or 55, depending on which contract they are employed under, and have 25 years of service. The City will pay 100 percent of the employee's premium and a portion of the dependent's premium, if any.

As of year end, there were 85 retired employees receiving benefits. The City finances the Plan on a pay-as-you-go basis. For the year ended December 31, 2005, the City's post-retirement health care cost under the Plan was approximately \$426,000.

Federal Grant

The City was the beneficiary of a \$220,000 MDOT grant, which was utilized to repave a portion of a City street. The value of this benefit was included in the Major Street Fund as federal revenues, but the City is not a subgrantee, and these funds are not subject to single audit at the City level. These revenues represent an MDOT grant and are subject to single audit as part of MDOT's audit.

Related Party Transactions

During the year ended, the DDA component unit contracted with a company for various services including, street cleanup, light maintenance work and some lot clearing. The company owner is a close relative of the former DDA director. Total expenses during the year ended December 31, 2005 is \$56,195.

City of Muskegon Heights
NOTES TO FINANCIAL STATEMENTS—CONTINUED
December 31, 2005

NOTE L—EMPLOYEE RETIREMENT SYSTEMS AND PENSION PLANS

Pension Plan

Plan Description. The City of Muskegon Heights is in an agent multiple-employer defined benefit pension plan with the Municipal Employees Retirement System (MERS). The Plan provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to Plan members and beneficiaries. Act No. 427 of the Public Acts of 1984 of the State of Michigan assigns the authority to establish and amend the benefit provisions of the plans that participate in MERS to the respective employer entities; that authority rests with the City of Muskegon Heights. A copy of the complete financial report and required supplemental information can be obtained by writing to:

City of Muskegon Heights
2724 Peck Street
Muskegon Heights, MI 49444

Funding Policy. City employees are required to contribute 3 to 6 percent to the Plan depending on employee contract. The City is required to contribute at an actuarially-determined rate depending upon position from 0 to 14 percent of covered wages.

Annual Pension Cost. For the year ended December 31, 2005, the City's annual pension cost was approximately \$212,000 which the City contributed. The required contribution was determined as part of the December 31, 2004 actuarial valuation using the entry age actuarial cost method. The actuarial assumptions included (a) 8 percent investment rate of return (net of administrative expenses), (b) projected salary increases ranging from 0 percent to 4.5 percent, and (c) 4.5 percent per year compounded annually attributable to inflation. The actuarial value of plan assets was determined using techniques that smooth the effects of short-term volatility in the market value of investments over a five-year period.

Three-Year Trend Information

<u>Year ended</u>	<u>Approximate Annual Pension Cost (APC)</u>	<u>Percent of APC contributed</u>	<u>Net Pension Obligation</u>
6/30/03	\$ 39,000	100%	\$ -
6/30/04	44,000	100	-
6/30/05	160,000	100	-

REQUIRED SUPPLEMENTARY INFORMATION

Schedule of Funding Progress

(Dollars amounts in thousands)

<u>Actuarial valuation date</u>	<u>Actuarial value of assets</u>	<u>Actuarial Accrued Liability (AAL) Entry Age</u>	<u>Unfunded AAL (UAAL)</u>	<u>Funded ratio</u>	<u>Covered payroll</u>	<u>UAAL as a percentage of covered payroll</u>
12/31/03	\$ 26,825	\$ 27,868	\$ 1,043	96%	\$ 3,982	26%
12/31/04	26,923	28,637	1,714	94	3,708	46
12/31/05	26,355	29,060	2,705	91	3,316	82

City of Muskegon Heights
NOTES TO FINANCIAL STATEMENTS—CONTINUED
December 31, 2005

NOTE L—EMPLOYEE RETIREMENT SYSTEMS AND PENSION PLANS—Continued

Deferred Compensation Plan

The City offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The Plan, available to all full-time City employees at their option, permits participants to defer a portion of their salary until future years. The deferred compensation is not available to participants until termination, retirement, death, or unforeseeable emergency.

The Plan has created a trust for the exclusive benefit of the Plan's participants and beneficiaries under rules provided in Internal Revenue Code Section 401(f).

NOTE M—ECONOMIC DEPENDENCY

State of Michigan shared revenues represent 31 percent of General Fund revenues.

The City's Water Supply Fund has a significant economic dependence on two other municipalities that are major users of water services. During the year ended December 31, 2005, the municipality's billings for water usage approximated 66 percent of total billings in the Water Supply Fund.

NOTE N—EQUITY RESTATEMENT

The General Fund fund balance and net assets were restated effective January 1, 2005. The fund balance and net assets were restated to reflect a previously unrecorded receivable and an accrual for payroll taxes.

	General Fund <u>fund balance</u>	Governmental activities <u>net assets</u>
Original balance at January 1, 2005	\$ 378,896	\$ 8,905,839
Receivable adjustment	40,000	40,000
Accrued payroll taxes	<u>(160,594)</u>	<u>(160,594)</u>
	\$ <u>258,302</u>	\$ <u>8,785,245</u>

The Downtown Development Authority net assets were restated higher due to an adjustment to property taxes for prior years and accounts receivable for back rent that was not properly recorded.

	<u>Net Assets</u>
Original balance at January 1, 2005	\$ 222,558
Taxes receivable adjustment	48,473
Accounts receivable adjustment	<u>94,468</u>
	\$ <u>365,499</u>

REQUIRED SUPPLEMENTARY INFORMATION

City of Muskegon Heights
Required Supplementary Information
BUDGETARY COMPARISON SCHEDULE
General Fund
For the year ended December 31, 2005

	Original budget	Final budget	Actual	Variance with final budget- positive (negative)
REVENUES				
Taxes	\$ 2,904,100	\$ -	\$ 3,105,561	\$ 3,105,561
Licenses and permits	120,000	-	101,353	101,353
Intergovernmental revenues				
Federal	30,000	-	34,718	34,718
State	1,895,880	-	1,867,958	1,867,958
Charges for services	680,300	-	711,490	711,490
Fines and forfeitures	12,000	-	44,713	44,713
Investment earnings	3,000	-	15,348	15,348
Other	125,000	6,249,816	218,047	(6,031,769)
Total revenues	5,770,280	6,249,816	6,099,188	(150,628)
EXPENDITURES				
Current				
General government				
City Council	42,506	42,506	47,954	(5,448)
Mayor	16,254	13,500	12,751	749
City manager	160,334	164,334	163,223	1,111
Personnel	9,000	8,500	9,404	(904)
Elections	10,800	10,000	10,118	(118)
Income tax	56,430	51,000	50,019	981
Assessor	126,903	134,903	139,855	(4,952)
City attorney	120,000	150,000	148,622	1,378
City clerk	49,013	65,200	67,130	(1,930)
Finance	124,016	126,500	134,563	(8,063)
Treasurer	52,392	52,300	51,933	367
Centennial Celebration	-	-	700	(700)
Data processing	1,200	5,000	4,087	913
Building and grounds	167,042	159,800	169,685	(9,885)
Other general government	848,571	879,734	915,238	(35,504)
Motor pool	65,000	65,000	72,898	(7,898)
Public safety				
Police	1,803,626	1,988,372	1,941,077	47,295
Auto theft grant	-	92,000	85,017	6,983
Fire	915,662	1,057,000	1,031,727	25,273
Inspections	201,396	181,396	179,370	2,026
Special investigations	-	3,000	2,283	717

City of Muskegon Heights
Required Supplementary Information
BUDGETARY COMPARISON SCHEDULE—CONTINUED
General Fund
For the year ended December 31, 2005

	Budgeted amounts			Variance with final budget- positive (negative)
	Original	Final	Actual	
Public works				
Public works	\$ 50,214	\$ 57,000	\$ 69,481	\$ (12,481)
Street lighting	200,000	170,000	159,155	10,845
Traffic	8,040	4,000	3,743	257
Refuse collection	410,000	500,000	494,104	5,896
Community and economic development				
Farmer's market	2,500	3,500	3,690	(190)
Planning	2,100	2,500	2,185	315
Culture and recreation				
Parks	143,922	143,922	163,289	(19,367)
Library	27,800	27,000	29,130	(2,130)
Mona Lake boat launch	-	1,800	1,679	121
Debt service				
Principal	52,111	14,101	28,534	(14,433)
Interest and fees	98,718	5,570	1,898	3,672
Capital outlay	19,000	14,500	85,668	(71,168)
Total expenditures	<u>5,784,550</u>	<u>6,193,938</u>	<u>6,280,210</u>	<u>(86,272)</u>
Excess (deficiency) of revenues over expenditures	(14,270)	55,878	(181,022)	(236,900)
OTHER FINANCING SOURCES (USES)				
Proceeds from sale of capital assets	35,000	35,000	18,012	(16,988)
Proceeds from long-term debt	-	-	65,816	65,816
Transfers in	-	-	51,157	51,157
Transfers out	(40,266)	(40,266)	(82,692)	(42,426)
Total other financing sources (uses)	<u>(5,266)</u>	<u>(5,266)</u>	<u>52,293</u>	<u>57,559</u>
Net change in fund balances	<u>\$ (19,536)</u>	<u>\$ 50,612</u>	(128,729)	<u>\$ (179,341)</u>
Fund balance at January 1, 2005, as restated			<u>258,302</u>	
Fund balance at December 31, 2005			<u>\$ 129,573</u>	

OTHER SUPPLEMENTAL INFORMATION

City of Muskegon Heights
COMBINING BALANCE SHEET
Other Governmental Funds
December 31, 2005

		Special Revenue Funds							Permanent Fund
	Total other governmental funds	Major Streets	Local Streets	Community Development Block Grant	Cemetery	Recreation	Capital Projects	Debt Service	Cemetery Perpetual Care
ASSETS									
Cash and investments	\$ 664,642	\$ 14,907	\$ 102,467	\$ 660	\$ -	\$ -	\$ 26,161	\$ 1,275	\$ 519,172
Receivables									
Accounts	53,612	-	-	-	50,281	-	-	-	3,331
Special assessments	135,296	133,579	1,717	-	-	-	-	-	-
Property taxes	56,477	-	-	-	-	56,477	-	-	-
Due from other funds	145,187	-	95,594	-	11,438	34,785	-	3,057	313
Due from other governmental units	281,593	94,811	34,750	152,032	-	-	-	-	-
Total assets	<u>\$ 1,336,807</u>	<u>\$ 243,297</u>	<u>\$ 234,528</u>	<u>\$ 152,692</u>	<u>\$ 61,719</u>	<u>\$ 91,262</u>	<u>\$ 26,161</u>	<u>\$ 4,332</u>	<u>\$ 522,816</u>
LIABILITIES AND FUND BALANCES (DEFICITS)									
Liabilities									
Accounts payable	\$ 94,322	\$ 48,449	\$ 2,253	\$ 20,539	\$ 10,664	\$ 12,417	\$ -	\$ -	\$ -
Accrued liabilities	10,260	3,783	981	3,140	1,712	644	-	-	-
Due to other funds	332,810	131,751	40,041	95,229	54,351	-	-	-	11,438
Deferred revenue	197,317	133,578	1,717	33,784	-	28,238	-	-	-
Total liabilities	634,709	317,561	44,992	152,692	66,727	41,299	-	-	11,438
Fund balances (deficits)									
Reserved for:									
Debt service	4,332	-	-	-	-	-	-	4,332	-
Capital projects	26,161	-	-	-	-	-	26,161	-	-
Perpetual care	511,378	-	-	-	-	-	-	-	511,378
Unreserved, undesignated									
Special revenue funds	160,227	(74,264)	189,536	-	(5,008)	49,963	-	-	-
Total fund balances (deficits)	702,098	(74,264)	189,536	-	(5,008)	49,963	26,161	4,332	511,378
Total liabilities and fund balances (deficits)	<u>\$ 1,336,807</u>	<u>\$ 243,297</u>	<u>\$ 234,528</u>	<u>\$ 152,692</u>	<u>\$ 61,719</u>	<u>\$ 91,262</u>	<u>\$ 26,161</u>	<u>\$ 4,332</u>	<u>\$ 522,816</u>

City of Muskegon Heights
COMBINING STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES (DEFICITS)
Other Governmental Funds
For the year ended December 31, 2005

		Special Revenue Funds							Permanent Fund
	Total other governmental funds	Major Streets	Local Streets	Community Development Block Grant	Cemetery	Recreation	Capital Projects	Debt Service	Cemetery Perpetual Care
REVENUES									
Property taxes	\$ 55,710	\$ -	\$ -	\$ -	\$ -	\$ 55,710	\$ -	\$ -	\$ -
Intergovernmental revenues									
Federal	679,853	220,000	-	459,853	-	-	-	-	-
State	849,764	622,299	227,465	-	-	-	-	-	-
Charges for services	219,605	-	-	-	172,050	33,678	-	-	13,877
Investment earnings	12,991	226	111	-	715	-	84	5	11,850
Other	89,073	11,685	3,768	-	250	265	73,105	-	-
Total revenues	1,906,996	854,210	231,344	459,853	173,015	89,653	73,189	5	25,727
EXPENDITURES									
Current									
General government	173,573	-	-	-	173,490	-	-	-	83
Public works	657,232	420,460	204,895	-	-	-	31,877	-	-
Community and economic development	366,304	-	-	366,304	-	-	-	-	-
Culture and recreation	137,869	-	-	-	-	137,869	-	-	-
Debt service									
Principal	92,888	14,320	-	57,752	816	-	-	20,000	-
Interest and fees	91,058	4,371	-	2,193	120	-	-	84,374	-
Capital outlay	358,309	338,921	-	8,531	10,200	657	-	-	-
Total expenditures	1,877,233	778,072	204,895	434,780	184,626	138,526	31,877	104,374	83
Excess of revenues over (under) expenditures	29,763	76,138	26,449	25,073	(11,611)	(48,873)	41,312	(104,369)	25,644
OTHER FINANCING SOURCES (USES)									
Proceeds from long-term debt	10,200	-	-	-	10,200	-	-	-	-
Transfers in	163,305	-	-	-	11,390	47,541	-	104,374	-
Transfers out	(99,229)	-	(21,682)	(25,073)	-	-	(41,084)	-	(11,390)
Total other financing sources (uses)	74,276	-	(21,682)	(25,073)	21,590	47,541	(41,084)	104,374	(11,390)
Net change in fund balances (deficits)	104,039	76,138	4,767	-	9,979	(1,332)	228	5	14,254
Fund balances (deficits) at January 1, 2005	598,059	(150,402)	184,769	-	(14,987)	51,295	25,933	4,327	497,124
Fund balances (deficits) at December 31, 2005	\$ 702,098	\$ (74,264)	\$ 189,536	\$ -	\$ (5,008)	\$ 49,963	\$ 26,161	\$ 4,332	\$ 511,378

City of Muskegon Heights
COMBINING STATEMENT OF ASSETS AND LIABILITIES
 Agency Funds
 December 31, 2005

	<u>Total agency funds</u>	<u>Tax Collection</u>	<u>Payroll Imprest</u>	<u>Woodcliffe Village</u>
ASSETS				
Cash and investments	\$ <u>724,456</u>	\$ <u>583,129</u>	\$ <u>107,705</u>	\$ <u>33,622</u>
 LIABILITIES				
Accounts payable	\$ 127,055	\$ 19,350	\$ 107,705	\$ -
Due to other governmental units	563,779	563,779	-	-
Deposits held for others	<u>33,622</u>	<u>-</u>	<u>-</u>	<u>33,622</u>
Total liabilities	\$ <u>724,456</u>	\$ <u>583,129</u>	\$ <u>107,705</u>	\$ <u>33,622</u>

BRICKLEY DELONG

CERTIFIED PUBLIC ACCOUNTANTS

June 30, 2006

City Council
City of Muskegon Heights
Muskegon Heights, Michigan

In planning and performing our audit of the financial statements of the City of Muskegon Heights for the year ended December 31, 2005, we considered its internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control.

However, we noted certain matters involving internal control and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control that, in our judgment, could adversely affect the City of Muskegon Heights' ability to initiate, record, process and report financial data consistent with the assertions of management in the financial statements. We have attached a summary of such reportable conditions.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that errors or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of internal control would not necessarily disclose all matters in internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. We believe that the recommendations in the Material Weaknesses section of the attached summary are material weaknesses.

This report is intended for the information and use of the City Council, management, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in black ink that reads "Brickley DeLong, PLC". The signature is written in a cursive, flowing style.

REPORTABLE CONDITIONS

The reportable conditions summarized below are categorized within two groups: material weaknesses and other reportable conditions. Within each of these two categories, the reportable conditions are divided between those noted during the December 31, 2005 audit and those noted during the December 31, 2004 and 2003 audits.

MATERIAL WEAKNESSES

Recommendation 1: The City Council should approve all expenditures before payment.

During our testing, we noted that the City Council did not approve accounts payable during the last six months of the fiscal year. The City Council should receive and approve all checks prior to distribution. The City Council does have the option to allow certain recurring cash disbursements such as payroll, payroll taxes and employee benefits to be disbursed with after the fact approval. However, the City Council needs to approve a policy to that effect.

The approval of all expenditures before payment would reduce the possibility of unauthorized disbursements and would enable the City to comply with State of Michigan requirements.

Recommendation 2: The Downtown Development Authority's cash disbursement procedures for services received should be improved.

During our testing, we noted that various cash disbursements for services were made without adequate supporting documentation. All accounts payable packages should have proper supporting documentation including documented evidence of receipt of service and business purpose.

The review and approval of the Downtown Development Authority cash disbursements by its Board of Directors or representative of the Board would reduce the possibility of funds being expended for unauthorized purposes.

OTHER REPORTABLE CONDITIONS

Accounts Payable

Recommendation 3: The City should remit the required pension payments to MERS on a timely basis.

During our testing, we noted that the City was a couple months behind at December 31, 2005 on remitting its required pension payments.

The timely remittance of pension payments would help ensure compliance with the pension plan established for the benefit of the City's employees.

OTHER REPORTABLE CONDITIONS—CONTINUED

Federal Programs

Recommendation 4: Community Development Block Grant (CDBG) program income should be reprogrammed and spent in a timely fashion.

During our testing, we noted that the CDBG grant had program income received and deferred related to two prior grant years. Federal guidelines require the use of program income for expenditures prior to requesting additional funds.

These monies should be reprogrammed and spent in timely fashion.

Recommendation 5: Time records documenting time allocation should be generated and maintained for employees whose salaries and wages are being allocated among accounts, departments and funds.

The City did not maintain time and effort distribution records for certain employees allocated to more than one revenue source, as required by federal regulations.

To avoid the potential loss of reimbursement for salaries and fringes charged to programs, detail time records must be maintained which substantiate the allocation of compensation expenditures.

Downtown Development Authority (DDA)

Recommendation 6: A formal conflict of interest policy should be established by the City and Downtown Development Authority (DDA).

The City and the DDA do not have formal conflict of interest policies. Due to the ever-increasing public scrutiny of local officials and policies, the establishment of a formal conflict of interest policy would assist in clearly defining a framework of policies and guidelines for conducting business.

The annual circularization and signing of conflict of interest statements by City Council, DDA board members and administrators would appropriately document the independence of these individuals.

Recommendation 7: The preparation and maintenance of Downtown Development Authority (DDA) board minutes should be improved.

During our testing, we requested copies of the DDA board minutes for the year ended December 31, 2005 through our audit opinion date. However, only a few meeting minutes could be located.

The DDA should formally document all meetings with board minutes signed by an appropriate board member. In addition, all minutes should be maintained and stored in a central location.

OTHER REPORTABLE CONDITIONS—CONTINUED

Downtown Development Authority (DDA)—Continued

Recommendation 8: The Downtown Development Authority (DDA) should improve procedures surrounding special event revenues and expenditures.

During our testing, we noted that net revenues from one DDA special event could not be found. A recap of the event was prepared which indicated that deposits should have been made, but no related bank deposits could be identified in the DDA accounting records. In addition, we noted various special event advances and reimbursements of expense that were not adequately documented.

The DDA should record all gross proceeds from special events in the DDA General Fund. Procedures should be enhanced to ensure that all special event revenues are received and properly accounted for in the DDA. All cash advances related to special events should be approved by properly authorized individuals, and supporting documents should be obtained within a reasonable amount of time.

The improvement of procedures surrounding DDA special event revenues and expenditures would reduce the opportunity for errors and/or the misappropriation of funds to go undetected.

PRIOR YEAR OTHER REPORTABLE CONDITIONS STILL APPLICABLE

We consider the following other reportable conditions contained in our June 28, 2005 letter as still applicable:

Recommendation 1: Internal control procedures should be further segregated.

Recommendation 3: Federal programs should be periodically reviewed to ensure compliance with grant agreements.

Recommendation 4: The budget should be amended as necessary to comply with Public Act 621.

Recommendation 5: The City should maintain complete and accurate Major Street Fund and Local Street Fund equipment rental schedules.

We consider the following other reportable conditions contained in our July 28, 2004 letter as still applicable:

Recommendation 3: The Community Development Block Grant Fund operating budget should be developed based upon anticipated expenditures during the year.

Recommendation 4: Property Tax Collection Fund cash collections and disbursements should be reconciled with supporting documents on an interim basis.